ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED JOINT PETITION OF DUKE ENERGY INDIANA, INC., INDIANAPOLIS POWER & LIGHT COMPANY, NORTHERN INDIANA PUBLIC SERVICE COMPANY AND VECTREN ENERGY DELIVERY OF INDIANA, INC. FOR APPROVAL, IF AND TO THE EXTENT REQUIRED, OF CERTAIN CHANGES IN OPERATIONS THAT ARE LIKELY TO RESULT FROM THE MIDWEST INDEPENDENT TRANSMISSION SYSTEM OPERATOR, INC.'S IMPLEMENTATION OF REVISIONS TO ITS OPEN ACCESS TRANSMISSION AND ENERGY MARKETS TARIFF TO ESTABLISH A CO-OPTIMIZED, COMPETITIVE MARKET FOR ENERGY AND ANCILLARY SERVICES MARKET; AND FOR TIMELY RECOVERY OF COSTS ASSOCIATED WITH JOINT PETITIONERS' PARTICIPATION IN SUCH ANCILLARY SERVICES MARKET.	CAUSE NO. 43426 PHASE I ORDER APPROVED: AUG 13 2008

BY THE COMMISSION:
David E. Ziegner, Commissioner
Loraine L. Seyfried, Administrative Law Judge

On January 18, 2008, Duke Energy Indiana, Inc. ("Duke"), Indianapolis Power & Light Company ("IPL"), Northern Indiana Public Service Company ("NIPSCO"), and Vectren Energy Delivery of Indiana, Inc. ("Vectren") (collectively "Joint Petitioners") filed a Verified Joint Petition with the Indiana Utility Regulatory Commission ("Commission" or "IURC"). The Commission granted intervention to the following parties in this proceeding: Indiana Industrial Group ("IIG"), LaPorte County Board of Commissioners ("LaPorte"), Midwest Independent Transmission System Operator, Inc. ("MISO" or "Midwest ISO"), Nucor Steel, a division of Nucor Corporation ("Nucor"), and Steel Dynamics, Inc. – Engineered Bar Products Division ("SDI").

On February 14, 2008, Joint Petitioners and the Indiana Office of Utility Consumer Counselor ("OUCC") filed a Joint Motion for (a) a Determination of the Extent to which Additional Commission Approval of Operational Changes is Required for Participation in the MISO ASM Market under Indiana Code 8-1-2-83 and (b) an Interim Order Allowing Utilities to Defer Reasonably Incurred Costs Pending Further Review ("Joint Motion"). In the Joint Motion, Joint Petitioners and the OUCC requested a preliminary order: (1) finding the extent to which additional Commission authority is necessary for the operational changes for the start of the Midwest ISO ancillary services market ("ASM"); (2) to the extent such additional Commission approval is required under Ind. Code § 8-1-2-83 setting a bifurcated procedural schedule to address the separate issues of (a) approval under Ind. Code § 8-1-2-83, and (b) cost recovery; and (3) allowing the Joint Petitioners to defer for future recovery reasonably incurred ASM charges, subject to determination of such recoverability in a final Commission Order on the issue of cost recovery.

On February 14, 2008, the Commission conducted a Prehearing Conference and Preliminary Hearing ("Prehearing Conference") in this Cause. Joint Petitioners, the OUCC and representatives from IIG, LaPorte, Midwest ISO, and Nucor appeared and participated at the Prehearing Conference. At the Prehearing Conference, the Joint Petitioners and the OUCC presented the Joint Motion described above. No party objected to the relief sought in the Joint Motion. Based upon the agreement set forth in the Joint Motion, the parties agreed on a bifurcated schedule to apply (1) with respect to Joint Petitioners' request for Commission approval, if and to the extent required, of operational changes necessary to permit Joint Petitioners to accomodate the Midwest ISO's ASM (the Authority of Joint Petitioners Issues) (herein referred to as "Phase I") and (2) with respect to Joint Petitioners' request for a Commission decision determining the manner and timing of recovery or crediting of jurisdictional charges and revenues associated with the Midwest ISO ASM (the Cost and Revenue Recovery Issues) (herein referred to as "Phase II"). On February 27, 2008, the Commission issued its Prehearing Conference Order establishing the schedule and other procedural requirements for this Cause.

To help define the issues to be addressed in Phase I, the Commission scheduled a Technical Conference for March 27, 2008 and found that the parties should confer and provide the Commission with a proposed agenda for the Technical Conference on or before March 20, 2008. The Commission was to provide the parties with any comments to the proposed agenda by March 25, 2008. In accordance with the procedural schedule, Joint Petitioners filed their proposed agenda on March 20, 2008 and the Technical Conference was held on March 27, 2008.

In accordance with the Prehearing Conference Order and scheduling modifications subsequently approved by the Presiding Officers, Joint Petitioners filed their prepared testimony and exhibits constituting their case-in-chief on March 17, 2008. Pursuant to 170 IAC 1-1.1-21, Joint Petitioners also requested the Commission to take administrative notice of the Federal Energy Regulatory Commission Order on Ancillary Services Filing issued February 25, 2008 in Docket Nos. ER07-1372-000 and ER07-1372-001, a copy of which was provided at that time (hereinafter referred to as "February 2008 FERC ASM Order"). By Docket Entry dated March 28, 2008, the Commission granted this request. The Midwest ISO filed its prepared testimony and exhibits on April 14, 2008. The OUCC and IIG filed their respective prepared testimony and exhibits on April 21, 2008. Joint Petitioners prefiled their rebuttal testimony on May 12, 2008.

Pursuant to the Prehearing Conference, the Prehearing Conference Order and scheduling modifications approved by the Presiding Officers, and notice of hearing given as provided by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, a public hearing in this Cause was conducted on June 12, 2008, in Room Judicial Courtroom 222 of the National City Center, Indianapolis, Indiana.

At the evidentiary hearing, the testimony and exhibits prefiled by the Joint Petitioners, Midwest ISO, OUCC and Intervenor IIG were admitted into the record and certain witnesses were cross-examined. In addition, the February 2008 FERC ASM Order was admitted as Joint Petitioners' Exhibit A. Proposed Orders were filed on June 26 and 27, 2008; Responses and Exceptions to Proposed Orders were filed on July 8, 2008.

Having considered the evidence and the applicable law and being duly advised, the Commission now finds as follows:

1. **Notice and Jurisdiction.** Due, legal and timely notice of the commencement of hearings held in this Cause was given and published by the Commission as required by law. Joint Petitioners are public utilities within the meaning of Ind. Code § 8-1-2-1. Ind. Code §§ 8-1-2-42, 8-1-2-61 and 8-1-2-83, among others, are or may be applicable to the subject matter of this proceeding. The Commission has jurisdiction over Joint Petitioners and the subject matter of this proceeding in the manner and to the extent provided by the laws of the State of Indiana.

2. **Joint Petitioners' Characteristics.**

A. **Duke.** Duke Energy Indiana is an Indiana corporation with its principal office in the Town of Plainfield, Hendricks County, Indiana. Duke Energy Indiana owns, operates, manages and controls plants, properties and equipment used and useful for the production, transmission, distribution and furnishing of electric utility service to the public in the State of Indiana. It directly supplies electric energy to over 770,000 customers located in 69 counties in the central, north central and southern parts of the State of Indiana. It also sells electric energy for resale to municipal utilities, Wabash Valley Power Association, Inc., Indiana Municipal Power Agency, Hoosier Energy Rural Electric Cooperative, Inc., and to other public utilities, which in turn supply electric utility service to numerous customers in areas not served directly by Duke Energy Indiana.

B. **IPL.** IPL is a corporation organized and existing under the laws of the State of Indiana, and has its principal office located at One Monument Circle, Indianapolis, Indiana. IPL renders retail electric utility service to approximately 470,000 retail customers located principally in and near the City of Indianapolis, Indiana, and in portions of the following Indiana counties: Boone, Hamilton, Hancock, Hendricks, Johnson, Marion, Morgan, Owen, Putnam and Shelby Counties. IPL owns, operates, manages and controls electric generating, transmission and distribution plant, property and equipment and related facilities, which are used and useful for the convenience of the public in the production, transmission, delivery and furnishing of electric energy, heat, light and power.

C. **NIPSCO.** NIPSCO is a corporation organized and existing under the laws of the State of Indiana, and has its principal office located at 801 East 86th Avenue, Merrillville, Indiana. NIPSCO renders retail electric utility service to approximately 441,000 retail customers in 21 counties in the northern part of Indiana. NIPSCO owns, operates, manages and controls electric generating, transmission and distribution plant, property and equipment and related facilities, which are used and useful for the convenience of the public in the production, transmission, delivery and furnishing of electric energy, heat, light and power.

D. **Vectren.** Vectren is a corporation organized and existing under the laws of the State of Indiana, with its principal office located at One Vectren Square, Evansville, Indiana. Vectren has charter power and authority to engage in, and is engaged in the business of rendering electric public utility service in the State of Indiana and owns, operates, manages and controls, among other things, plant and equipment within the State of Indiana used for the production, transmission, delivery and furnishing of such service to approximately 140,000 ultimate electric customers in southwestern Indiana.

3. **Background and Introduction.**

A. Joint Petitioners' Participation in the Midwest ISO. On February 1, 2002, Joint Petitioners Duke Energy Indiana, IPL and Vectren transferred functional control of the operation of their respective transmission systems to the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO") and began taking transmission service under the Midwest ISO Open Access Transmission Tariff ("OATT") to serve their Indiana retail electric customers in accordance with Federal Energy Regulatory Commission ("FERC") Opinion No. 453 and Opinion No. 453-A.[1] The Commission approved that transfer of functional control on December 17, 2001.[2] As of October 1, 2003, NIPSCO transferred functional control of its transmission operations to the Midwest ISO in compliance with the Commission order in Cause No. 42349, issued September 24, 2003, and began taking transmission service under the Midwest ISO OATT to serve its Indiana retail electric customers.

On March 31, 2004, the Midwest ISO filed a proposed Open Access Transmission and Energy Markets Tariff ("Energy Markets Tariff" or "TEMT") with the FERC in Docket No. ER04-691-000. The Midwest ISO's proposed Energy Markets Tariff set forth rates, charges, terms and conditions for the implementation of a centralized security-constrained economic dispatch platform supported by a day-ahead and real-time energy market design, including locational marginal pricing ("LMP") and financial transmission rights ("FTRs") within the Midwest ISO region. On May 26, 2004, the FERC directed the Midwest ISO to implement energy markets (also known as "Day 2 energy markets") in the Midwest ISO region on March 1, 2005.[3]

On July 9, 2004, Joint Petitioners sought Commission approval for their participation in the real-time and day-ahead energy markets within the Midwest ISO region. On June 1, 2005 in Cause No. 42685, the Commission issued an Order approving the transfer of certain Joint Petitioners' control area operations and their participation in the Day 2 energy markets ("June 1st Order").

B. Ancillary Services Market Implementation. On February 15, 2007 in FERC Docket No. ER07-550, the Midwest ISO filed revisions to its TEMT designed to establish a co-optimized, competitive market for energy and operating reserves (the Ancillary Services Market, hereinafter referred to as "ASM"). On June 22, 2007, the FERC issued its Order on the Midwest ISO's ASM filing. In its Order, the FERC rejected the filing because it lacked the necessary market power analysis and a readiness and reversion plan.[4] The FERC also provided guidance on certain market design issues, choosing not to address certain other issues raised by intervenors. On September 14, 2007, the Midwest ISO re-filed its ASM proposal in FERC Docket No. ER07-1372. On February 25, 2008 in Docket Nos. ER07-1372-000 and ER07-1372-001, FERC issued an Order that conditionally accepted for filing the Midwest ISO's proffered ASM tariff.[5] In compliance with the February 25, 2008 order, the Midwest ISO has submitted required compliance filings. The Midwest ISO has submitted the "Agreement between Midwest ISO and Midwest ISO Balancing

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1 *Midwest Independent Transmission System Operator, Inc.*, Opinion No. 453, 97 FERC P61,033 (2001); *order on reh'g*, Order No. 453-A, 98 FERC P61,141 (2002).

2 *Hoosier Energy Rural Elec. Cooperative, Inc., et al.*, Cause No. 42027 (IURC 12/17/2001).

3 *Midwest Independent Transmission System Operator, Inc.*, 107 FERC P61,191 at ¶ 94 (May 26, 2004) ("the Commission directs the Midwest ISO to move the start of the energy market from December 1, 2004 to March 1, 2005"). Following additional testing, the energy markets actually took effect on April 1, 2005.

4 119 FERC P61,311, *reh'g denied*, 120 FERC P61,202 (2007).

5 122 FERC P61,172 (2008).

Authorities Relating to Implementation of TEMT, as Amended on March 14, 2008" (hereinafter referred to as the "Amended BA Agreement"), which was admitted into evidence in this Cause as Joint Petitioners' Exhibit 2-B.[6] The Midwest ISO's ASM is currently scheduled to become operational on September 9, 2008.[7]

4. Relief Requested in Phase I. In this Cause, Joint Petitioners have requested that the state regulatory implications of the Joint Petitioners' participation in the ASM be addressed by this Commission. Citing to prior Commission orders addressing the Joint Petitioners' participation in the Midwest ISO, Joint Petitioners assert that this Commission has stated a policy of supporting the development of a regional market and a market-based mechanism to manage transmission congestion.[8] Therefore, Joint Petitioners have requested that this Commission investigate the implications of the Midwest ISO's implementation of the ASM and thereafter issue an order in Phase I of this proceeding: (1) if and to the extent required, approving operational changes necessary to permit Joint Petitioners to accommodate the Midwest ISO's ASM; and (2) allow for the deferral of certain identified costs pending the outcome of Phase II of this proceeding.

5. Approval of Operational Changes Necessary to Allow Joint Petitioners to Participate in ASM.

A. Transfer of Control Area Operations Responsibilities.

(1) Joint Petitioners' Evidence. Joint Petitioners' witness, Mr. William Jett, referenced FERC's 2004 order approving the start of the Midwest ISO energy markets, as well as the Commission's order authorizing Joint Petitioners' participation in the Midwest ISO energy markets (Cause No. 42685) in support of his opinion that through co-optimization of transmission, generation and reserves by means of ASM, the Midwest ISO is positioned as intended by FERC, to be able to pursue the most efficient utilization of membership assets. He further stated that Joint Petitioners' participation in ASM will be operationally consistent with both FERC and Commission regulatory directives and approvals previously received and will be supportive of the Midwest ISO's efforts to respond to the FERC policy objectives of a fully integrated, efficient, and transparent transmission and generation market.

Douglas E. Hils, Director, System Operations, of Duke Energy Shared Services, Inc. described the transfer of additional tasks associated with the North American Electric Reliability Corporation ("NERC") balancing authority function to the Midwest ISO upon the start of the Midwest ISO ASM. The NERC functional model defines the functions that must be performed to ensure the reliability of the bulk electric system, including the balancing function performed by the

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[6] On June 23, 2008, FERC issued an Order Granting In Part And Denying In Part Rehearing And Granting Clarification, *See, Midwest Independent Transmission System Operator, Inc.*, 123 FERC P61,297 (2008) and an Order Conditionally Accepting Compliance Filing, *See, Midwest Independent Transmission System Operator, Inc.*, 123 FERC P61,296 (2008). While these orders dealt with numerous specific implementation and market design issues, FERC generally re-affirmed the central elements of the ASM proposal.

[7] FERC's June 23, 2008 Order Conditionally Accepting Compliance Filing accepted a revised ASM start-up date of September 9, 2008. 123 FERC P61,296 (2008).

[8] *See Joint Petitioners' Petition* at p. 12, citing *In re Joint Petition of PSI Energy, Inc. and Vectren Energy Delivery of Ind., Inc.,* Cause Nos. 42257 and 42266, 2002 Ind. PUC LEXIS 571, at *10 (IURC 12/11/2002) and *Hoosier Energy Rural Elec. Cooperative, Inc., et al.,* Cause No. 42027 at p. 9 (IURC 12/17/2001).

entity or entities responsible for the balancing function (the "Balancing Authority"). Among other duties, the Balancing Authority integrates resource plans ahead of time, maintains load-interchange-generation balance within a "Balancing Authority Area", and supports interconnection frequency in real-time.

Mr. Hils testified that ancillary services are the services necessary to support transmission system capacity and the transmission of electricity from generating resources to loads while maintaining reliable operation of the transmission system in accordance with good utility practice. He stated that ancillary services markets are financial settlement markets for the efficient acquisition and pricing of ancillary services under a FERC-filed tariff. Such markets are intended to provide a clear identification of ancillary services products to allow market participants to compete to supply services to the market operator for provision to the applicable transmission customers. He asserted that ancillary service markets provide transparent economic signals to govern the provision of these services and reconcile operating practices with market incentives so that market participants are compensated for providing products needed for reliability. He opined that such markets strive to correctly price energy and ancillary services under all system conditions, particularly shortage conditions, to provide incentives for actions that support the reliable operation of the bulk electric system.

Mr. Hils stated that the ancillary services products to be provided in the Midwest ISO ASM consist of regulating, spinning, and supplemental reserves. He explained that spinning and supplemental reserves are typically used to meet conditions such as the sudden unexpected loss of generation and are often referred to as contingency reserves. Regulating reserves consist of those generation and load sources that are available to balance real-time load and generation second-by-second. He testified that the Midwest ISO will use automatic generation control ("AGC") functions to adjust resources to maintain Area Control Error ("ACE") in accordance with NERC generation control performance requirements.

Mr. Hils testified that contingency reserves are required to re-balance load and generation after system disturbances, such as unexpected generation and transmission outages, and that spinning reserves are commonly provided by on-line generating units that can increase loading within 10 minutes. Non-spinning or supplemental reserves are commonly provided by off-line units, such as quick-start peakers, that can be started and loaded to the required amount within 10 minutes. He stated that loads that can be interrupted in 10 minutes may also qualify as spinning, or non-spinning or supplemental, reserves depending upon the performance requirements established by the Midwest ISO. He explained that the total contingency reserve requirement for the Midwest ISO Region must be capable of covering the most severe single contingency within 15 minutes of the actual loss time.

Mr. Hils explained that currently each Balancing Authority (which will be re-classified as a Local Balancing Authority or an "LBA" under ASM), including each Joint Petitioner, is responsible for providing ancillary services. Therefore, each Balancing Authority must have resources available to them to supply regulating reserves and contingency reserves. Upon the start of the ASM, the provision of regulating reserves and contingency reserves to transmission customers of the Midwest ISO will no longer be the responsibility of the individual Balancing Authorities, rather it will be the responsibility of the Midwest ISO to procure such resources through its ASM. He stated that market participants will sell and purchase these ancillary services in the Midwest ISO's day ahead and real-time ASM and energy markets.

Mr. Hils explained that pursuant to the Amended BA Agreement the Midwest ISO will be responsible for calculating the ACE for the Midwest ISO Region, maintaining the ability to run AGC, compliance with control performance standards such as CPS1 as specified in NERC Standard BAL-001-0, compliance with the NERC disturbance control standard ("DCS") as specified in NERC Standard BAL-002-0, repayment of its Inadvertent Interchange balance with the Eastern Interconnection, and forecasting load-resource balance and operating reserve requirements. Mr. Hils stated that currently there are multiple Balancing Authorities within the Midwest ISO, each performing the tasks and responsibilities required of Balancing Authorities. When ASM takes effect the Midwest ISO will have primary responsibility for these functions, although LBAs will continue to have significant responsibilities. The Midwest ISO will be responsible for 359 out of the 365 current NERC Standards requirements assigned to the Balancing Authority function. And, 115 of those will be the sole responsibility of the Midwest ISO. The LBAs, including each of the Joint Petitioners, will have joint responsibility with the Midwest ISO for 244 of the NERC Standards, and sole responsibility for 6, for a total of 250 of the NERC Standards.

Mr. Hils testified that presently each Balancing Authority is responsible for meeting the NERC DCS. This standard requires that the Balancing Authority restore its ACE within 15 minutes from the actual loss time of a resource through utilization of its contingency reserves. Each Balancing Authority is, therefore, responsible for having contingency reserves available to it for implementation within the required time. Mr. Hils stated that under the Amended BA Agreement, the compliance responsibility for the DCS will move to the Midwest ISO, which will determine the appropriate mix of contingency reserves necessary to comply with the NERC DCS requirement. Mr. Hils asserted that procurement of such reserves by the Midwest ISO under ASM is expected to be more efficient and effective than the status quo.

Mr. Hils further explained that the Balancing Authorities under the Midwest ISO Day 2 energy markets are responsible for regulating resources as needed for each to individually meet the NERC control performance requirements. He stated that at times the 5-minute Midwest ISO energy market dispatch may be guiding resources in a direction opposite to what the Balancing Authority needs for regulation in real-time to balance its system due to a load swing or other factors not anticipated in the market dispatch. Another Balancing Authority at the same time may need to move generation in the opposite direction to address its real-time balance. When looking at the net impact of over twenty Balancing Authorities within the Midwest ISO energy market footprint taking individual actions to balance their respective systems, one can assess that such movement in resources would not be as necessary if the regulation need were determined for the Midwest ISO Region. For the Day 2 energy market, consolidation of the load took place for the reliability-constrained economic dispatch, but not for the real-time regulation of resources to balance the various Balancing Authority areas. Mr. Hils concluded that the ASM is the next logical step in gaining similar efficiency in the control of resources in real time to provide regulating service within the Midwest ISO Region.

Mr. Hils described the activities that have taken place to prepare for the ASM, including certification by NERC of the Midwest ISO as the Balancing Authority. Among other matters, the LBAs under the Amended Balancing Authority Agreement have prepared their respective energy management systems to interface with the Midwest ISO energy management system. Operational tests have been conducted to ascertain the Midwest ISO's capability to move generation within the LBA areas to balance to a Midwest ISO ACE. He also indicated additional operational tests are planned and a Midwest ISO stakeholder group has been reviewing Midwest ISO Business Practices Manuals applicable to ASM.

(2) Midwest ISO's Evidence. Mr. Roger Harszy, Vice President of Real Time Operations for the Midwest ISO, testified on behalf of the Midwest ISO, an intervenor in this proceeding. Mr. Harzy provided a further description of ASM, its operational impacts and the realignment of balancing authority functions between the Midwest ISO and the LBAs. In addition, he reviewed Midwest ISO readiness for the start of ASM operations and briefly described the operational value of the functional consolidation of the existing balancing authorities. Mr. Harzy stated that the procurement of reserves by the Midwest ISO is expected to be more efficient than the individual efforts of the current 23 different Balancing Authorities. Further, he stated that upon implementation of the ASM, if one balancing authority is increasing generation for balancing purposes, while a neighboring balancing authority is simultaneously reducing generation for its balancing purposes, such effects can be netted and the overall requirement for regulation reduced. He said this is the next logical step to gain efficiencies in the control of resources in real time to provide regulation service more effectively.

With respect to the Midwest ISO's readiness for ASM, Mr. Harzy explained the steps involved in the development of ASM and the process leading to the recommendation by the regional reliability organizations for certification of the Midwest ISO as the Balancing Authority. He also described testing of ASM operations, including the successful completion of 6 tests where the Midwest ISO deployed regulation and reserves to balance the entire Midwest ISO Balancing Authority footprint in real time. Mr. Harzy referred to the Midwest ISO filing with FERC dated April 3, 2006, which indicated estimated net annual benefits in the range of $147-$301 million per year. He testified that "[t]hese economic benefits are a direct result of utilization of a footprint wide reserve pool, as well as efficient use of contingency and regulating reserves across the entire footprint."[9]

(3) OUCC's Evidence. OUCC witness Andrew J. Satchwell testified that the OUCC believes the Midwest ISO's proposed ASM and balancing authority alignment will not adversely impact reliability and should provide overall benefits. In particular, he stated that ASM will provide market efficiencies, including transparent economic signals, ensuring proper compensation to market participants for providing reliability and correctly pricing ancillary services under shortage conditions. He further noted that in Cause No. 42027, a petition seeking participation in Midwest ISO, the Commission set forth in its Order a set of public interest factors directly applicable to that cause: reliability, financial viability, impact on competition, impact on efficiency and rates and access to information.[10] Mr. Satchwell indicated these public interest factors would either not be adversely affected or would be improved with ASM. He concluded by indicating he expected economic benefits for the Midwest ISO footprint as a whole. However, he stated the extent to which retail customers benefit will depend on retail cost recovery, which is to be considered in Phase II of this proceeding.

(4) IIG's Evidence. James Dauphinais, a consultant with Brubaker and Associates, Inc., provided testimony on behalf of the Indiana Industrial Group. Mr. Dauphinais testified that under

[9] Midwest ISO Exhibit RCH, p. 21.
[10] *Hoosier Energy Rural Elec. Cooperative, Inc., et al.,* Cause No. 42027 (IURC 12/17/2001).

the current Midwest ISO Day 2 energy market, there is a bid-based market for energy. However, each of the individual balancing authorities, including each of the Joint Petitioners, must set aside a portion of its generation capacity to provide moment-to-moment balancing between supply and demand within that balancing authority, and sufficient contingency reserves to meet that balancing authority's obligations under the Midwest Contingency Reserve Sharing Group. He stated that under the ASM, each of the Joint Petitioners will no longer be responsible for operation of own balancing authority and will no longer need to set aside capacity to provide regulation and contingency reserves. Instead, the Joint Petitioners will offer or self-schedule their entire generation capability into the Midwest ISO and continue to bid their native load demand into the Midwest ISO. He explained that the Midwest ISO will be responsible for clearing sufficient capacity and energy to meet the needs of the Midwest ISO market footprint for energy, regulation and contingency reserves.

Mr. Dauphinais asserted that the Joint Petitioners had provided incomplete evidence that it is in the public interest for the Commission to approve the operational changes necessary to permit the Joint Petitioners to accommodate the ASM. Mr. Dauphinais argued that the Joint Petitioners' evidence that the ASM will provide the Midwest ISO with tools necessary to pursue the most efficient utilization of assets and gains in efficiency from consolidating the acquisition and deployment of contingency reserves does not necessarily mean that such gains in efficiency will ultimately be realized in the form of lower costs for the ratepayers of Joint Petitioners.

Mr. Dauphinais noted that each of the Joint Petitioners indicated in discovery that they will not be able to opt out of the ASM so long as they are members of the Midwest ISO. He also noted that during the Phase I Technical Conference in this proceeding, the Midwest ISO presented the cost-benefit study summary originally filed with the FERC in the early part of 2006, which projected an annual savings of between $113 million and $208 million for the Midwest ISO footprint for the ASM, with an annual operating and amortized capital expense of $25 million. However, he also noted that the study only examined energy production cost savings on a Midwest ISO-wide basis; did not attempt to project the market price for ancillary services upon start of the ASM; and did not specifically examine the impact of ASM on Indiana or any of the Joint Petitioners.

Mr. Dauphinais testified that he believes if the ASM works as assumed in the production cost simulations the Midwest ISO performed in 2006, energy production costs on a Midwest ISO-wide basis will fall in the manner projected by the Midwest ISO due to the likely efficiency gains that will come from consolidating regulation and contingency reserve responsibilities from multiple balancing authorities to a single balancing authority. Consequently, Mr. Dauphinais indicated that it was reasonable for the Commission to grant authority to the Joint Petitioners to participate in the ASM, so long as certain conditions were approved. The Commission addresses those conditions hereinafter.

(5) Joint Petitioners' Rebuttal. In rebuttal, Mr. Jett noted that Joint Petitioners have already received authority from the Commission to transfer functional control of certain operations to the Midwest ISO in Cause Nos. 42027 and 42685. He stated that the ASM is essentially an expansion of the Day 2 Energy Markets, which was contemplated by FERC and the Midwest ISO at the time of the Day 2 Energy Markets' start-up. He asserted that as members of the Midwest ISO and because the ASM has been approved by FERC, Joint Petitioners do not have an option as to whether to utilize the ASM in some manner, short of withdrawing from the Midwest ISO, and noted that no party is suggesting in this proceeding that Joint Petitioners withdraw from the Midwest ISO. He concluded that the Commission may take the position that it does not need to authorize Joint Petitioners to enter the ASM or that it has previously provided Joint Petitioners with adequate authority to enter into the revised Energy Markets, including the ASM. He noted that the OUCC and IIG appear to recognize the necessity of Joint Petitioners' participation in the ASM, given that FERC has approved the ASM and that Joint Petitioners are members of the Midwest ISO.

(6) Commission Discussion and Findings. Joint Petitioners are required to seek Commission approval of operational changes pursuant to Ind. Code § 8-1-2-83, which states in pertinent part:

> Sec. 83. (a) No public utility, as defined in section 1 of this chapter, shall sell, assign, transfer, lease, or encumber its franchise, works, or system to any other person, partnership, limited liability company, or corporation, or contract for the operation of any part of its works or system by any other person, partnership, limited liability company, or corporation, without the approval of the commission after hearing. . . .

The Commission's prior approvals concerning Joint Petitioners' participation in the Midwest ISO were limited to the operational changes identified in those proceedings, and did not address the transfer of operational control necessary for the Midwest ISO ASM. Specifically, the Commission's December 17, 2001 Order in Cause No. 42027 (approving the Midwest ISO as the RTO choice of PSI, IPL and Vectren) stated, in pertinent part:

> In this proceeding, the MISO applicants have sought permission to transfer to MISO the functional control of their transmission assets. Our approval is limited to this request. We wish there to be no misunderstanding of this point. We therefore condition our present approval on the understanding that the MISO applicants must seek and obtain this Commission's approval regarding any future requests governed by IC § 8-1-2-83.

Joint Petition of Hoosier Energy Rural Elec. Coop. Inc. et al., Cause No. 42027 (IURC 12/17/01) at p. 23.

This Commission's June 1, 2005 Order in Cause No. 42685 (approving all of Joint Petitioners' participation in the Midwest ISO's Day 2 Energy Market) stated:

> We find that transfer of control area operations is required for the Joint Petitioners' to participate in the Day 2 energy markets and that the division of responsibilities between the Midwest ISO and Joint Petitioners as Balancing Authorities will be governed by a FERC-approved agreement (i.e., the Balancing Authority Agreement). Based upon the evidence presented, we find that Joint Petitioners should be granted authority to transfer control area operation tasks and responsibilities to the Midwest ISO as described in the testimony of Witness Hils. (p. 8)
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> Based upon the evidence presented, we find that Joint Petitioners should be granted authority to participate in the Midwest ISO Day 2 directed dispatch and Day 2 energy markets as described in their testimony. (p. 13)

Therefore, Commission approval is required for the operational changes necessary to permit Joint petitioners to accommodate the Midwest ISO's ASM. Based on the evidence presented, the Commission finds that the transfer of operational control requested by Joint Petitioners in this proceeding for the start of the Midwest ISO ASM is reasonable, in the public interest based upon the five factors set forth in the Commission's December 17, 2001 Order in Cause No. 42027:

(a) Reliability. The ASM provides for certain reassignments of existing reliability functions from the Midwest ISO's current Balancing Authority Areas to the Midwest ISO. The evidence presented demonstrates that current reliability requirements will continue to be met, but in a more centralized approach that should provide improved, or at least maintain equal reliability of the electrical system. NERC performed a thorough review of the Midwest ISO's readiness and certified the Midwest ISO to act as a single Balancing Authority. The Midwest ISO is also conducting ASM functionality testing with market participants, including Joint Petitioners, to ensure that the ASM is reliable and efficient upon launch. As described in FERC's February 25, 2008 Order, the Midwest ISO will also use an independent market readiness advisor to certify the Midwest ISO's readiness to begin ASM operations in advance of the planned start date.[11] In addition, FERC has ordered the Midwest ISO to have reversion plans in place to ensure continued functionality in the event of significant ASM operational problems.[12] Therefore, the Commission finds the evidence demonstrates that measures are adequately in place to ensure continued reliability when ASM is implemented.

(b) Financial Viability. As indicated above, the Midwest ISO began providing transmission services under its OATT on February 1, 2002 and began implementing the Day 2 energy markets on April 1, 2005. In Cause No. 42027, the Commission found that the Midwest ISO was financially viable and independent of its participating transmission owners.[13] No evidence to the contrary has been provided in this Cause.

(c) Impact on Competition. The Commission recognizes that regional transmission organizations ("RTOs") are designed to improve overall competition and access to resources in wholesale energy markets. The ASM is intended to facilitate competition for, and market-based pricing of, operating reserves. In addition, the ASM's simultaneous co-optimization of operating reserves and energy markets should allow the Joint Petitioners' generation resources to compete in the broadest range of markets. Based on the evidence presented, we find that the ASM should result in increased opportunities for competition by Joint Petitioners in the Midwest ISO markets.

(d) Efficiency and Rates. The Commission will more fully consider the ratemaking and cost recovery treatment of ASM charges in Phase II of this proceeding. However, based upon the evidence presented, we find that the ASM should have a positive impact on efficiency and rates. We expect ASM to result in a more efficient unit dispatch, as units which can produce energy at the lowest cost will no longer be dispatched below their full capacity when other units are capable of providing operating reserves more cost effectively. Although the evidence is uncertain as to the specific impact that ASM will have upon each Joint Petitioner's rates, we find that the evidence does demonstrate that ASM is designed to, and should result in, lower overall market costs. And,

[11] 122 FERC P61,172 at ¶ 448 (2008).

[12] *Id.* at ¶¶ 459-462.

[13] *Hoosier Energy Rural Elec. Cooperative, Inc., et al.,* Cause No. 42027, p. 13 (IURC 12/17/2001).

such gains in efficiency and lower overall market costs should make lower costs possible for ratepayers.

(e) Access to Information. Pursuant to Ind. Code § 8-1-2-48, the Commission has the authority to require access to all necessary information to enable the Commission to perform its duties. In addition, methods for providing information from the Midwest ISO to the Commission currently exist in the Midwest ISO stakeholder process. Therefore, the Commission finds sufficient access to information exists concerning Joint Petitioners' participation in the ASM.

B. Conditions Regarding Participation in ASM. In the testimony filed by the OUCC and IIG in this Cause, various suggestions were made regarding conditions that should be imposed on Joint Petitioners' participation in the ASM. We will address each condition individually.

(1) Request for Cost Benefit Study.

(a) OUCC Evidence. OUCC witness Mr. Satchwell opined that each Joint Petitioner should track costs and benefits associated with the ASM on an individual, system-wide basis. He asserted that it is important that the utility and regulators understand the cost impact of participating in the ASM and how the benefits of participation may or may not offset that cost.

Mr. Satchwell stated the OUCC had three recommendations for tracking costs and benefits. First, each Joint Petitioner should include incremental ASM costs and benefits in their Fuel Adjustment Clause filings ("FACs"). Second, two years after commencement of the Midwest ISO ASM, the Joint Petitioners should file a detailed cost-benefit report evaluating their respective participation in the Midwest ISO ASM. And, finally, the Joint Petitioners should work with Commission staff, the OUCC and other interested stakeholders to develop appropriate methodology for implementing these recommendations.

(b) IIG Evidence. IIG witness Mr. Dauphinais testified that, in light of the Midwest ISO's 2006 cost-benefit study in regard to regional benefits, it is reasonable to allow participation by the Joint Petitioners in the Midwest ISO's ASM. However, such participation should be conditioned on each Joint Petitioner examining, after sufficient experience with operation of the ASM has been gained, the cost-benefit to their ratepayers of continued participation in the Midwest ISO. Mr. Dauphinais recommended that two years after the commencement of the operation of the Midwest ISO ASM, the Joint Petitioners should file a detailed cost-benefit study evaluating their respective participation in the Midwest ISO. The study should include identification of whether the benefits of Midwest ISO participation are flowing through to ratepayers, and areas where improvements can be made at either, or both, the Joint Petitioners and the Midwest ISO to the benefit of ratepayers. Mr. Dauphinais testified that the study should be performed in consultation with the Commission, the OUCC and those other parties to this proceeding that are interested in participating in the study process. He stated that such consultation should include allowing participants to provide meaningful input in regard to the selection of the assumptions utilized in the study. He concluded that interested parties should be permitted to file comments with the Commission on the study after it is filed.

(c) Joint Petitioners' Rebuttal Evidence. Joint Petitioners' witness Mr. William Jett stated that Joint Petitioners should not be required to conduct a detailed cost-benefit study as recommended by the OUCC and IIG for several reasons including: (1) there is no requirement that a detailed cost/benefit analysis be prepared on an individual company basis in order for the Commission to approve the requested relief herein and, in any event, the Midwest ISO has already prepared such a study showing the benefits of ASM on a footprint wide basis; (2) a study focused only on the local benefits to a specific utility ignores the reality of the regional market; and (3) it would be extremely difficult or even impossible to perform such a study that provides meaningful results, and such a study would unduly tax the resources of the utilities, especially if costs and benefits were required to be submitted with each fuel clause filing as proposed by the OUCC.

Joint Petitioners' witness John Swez also testified that based on his experience in Cause No. 38707-FAC67S1, a cost/benefit analysis would be difficult, if not impossible to perform, requiring many assumptions that may or may not be accurate. He testified that it was difficult to analyze and quantify the impacts of just one change in how one market participant interacted with the Midwest ISO during a relatively short period of time. Given the co-optimization of the ASM and Day 2 Energy Markets, Mr. Swez stated that it is simply not feasible, on a utility-specific basis, to reasonably demonstrate specific customer costs or benefits that would have occurred had the utilities not participated in ASM.

Joint Petitioners' witness Jett testified that in its approval of the ASM, FERC noted:

> We agree with the Midwest ISO that a centralized ASM provides significant reliability and efficiency benefits and, based on the operating experience of similar ASMs in the other ISOs and RTOs, we expect those benefits will also be realized in the Midwest ISO, particularly since the Midwest ISO has designed a market that incorporates the best features of other ASMs.[14]

He also noted that FERC did not require additional cost/benefit analysis in approving the ASM, finding that it had broad authority to consider both non-cost and cost factors in its decision.[15]

(d) Commission Discussion and Findings. Both IIG and the OUCC have recommended that the Commission require Joint Petitioners to perform studies two years following the start of the ASM. IIG recommended the Joint Petitioners be required to file a detailed cost-benefit study evaluating their respective participation in the Midwest ISO; whereas, the OUCC recommended the Joint Petitioners be required to file a detailed cost-benefit study evaluating their respective participation in the Midwest ISO ASM. The OUCC also recommended that each Joint Petitioner include incremental ASM costs and benefits in their FAC filings.

The Commission recognizes that the Midwest ISO has conducted a cost-benefit analysis showing the benefits of ASM on a footprint wide basis and understands that the Midwest ISO has proposed to create a task force to work with stakeholders and state commission representatives to perform an ongoing analysis of the costs and benefits associated with the ASM. However, neither the 2006 cost-benefit analysis nor the task force addresses, or will address, the costs and benefits to each of the Joint Petitioners and their ratepayers associated with their participation in the Midwest ISO or ASM. We agree with the OUCC that it is important for each of the Joint Petitioners and the

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[14] *Midwest ISO Ancillary Services*, FERC Docket Nos. ER07-1372-000 and ER07-1372-001, 122 FERC P61,172, at ¶ 24 (February 25, 2008).

[15] *Id.* at ¶ 25.

Commission to understand, as much as reasonably possible, the cost impact of participating in the ASM and how the benefits of participation in the Midwest ISO may or may not offset that cost.

As set forth above, we found sufficient evidence exists to support authorization of the Joint Petitioners' participation in Midwest ISO's ASM and therefore decline to condition their participation in ASM on the performance of a cost-benefit analysis. However, while the Commission has supported the development of regional markets, we also have the responsibility to ensure that Indiana utilities and ratepayers are fairly treated by those markets. Therefore, the Commission finds it is reasonable to further explore the issues associated with performing a cost-benefit analysis or requiring Joint Petitioners to provide additional cost-benefit information in their FAC filings, as a means for providing information concerning Joint Petitioners' experiences in the Midwest ISO ASM, and allowing for further evaluation of whether the anticipated benefits are being realized.

Consequently, the Commission finds a subdocket should be created to allow for further consideration of whether, and to what extent if any, a cost-benefit analysis of the Joint Petitioners participation in the Midwest ISO or the Midwest ISO ASM should be performed, and whether any additional data concerning ASM costs and benefits should be provided in the Joint Petitioners' respective FAC filings.

(2) Responsibility to Operate on a Least Cost Basis.

(a) IIG Evidence. Mr. Dauphinais suggested that the Commission should clarify that any approval of the Joint Petitioners' participation in the ASM does not absolve them of their ultimate responsibility to operate their respective systems on a least cost basis.

(b) Joint Petitioners' Rebuttal Evidence. Joint Petitioners' witness Mr. William Henley addressed IIG's suggestion that Joint Petitioners have a responsibility to operate their systems "on a least cost basis." He testified that IIG has misstated Joint Petitioners' responsibility, which is to furnish reasonably adequate service and facilities at reasonable and just rates.[16] He noted that to be granted a change in its fuel charge, for example, an electric utility must show that it has made "every reasonable effort to acquire fuel and generate or purchase power or both so as to provide electricity to its retail customers at the lowest fuel cost reasonably possible."[17] Mr. Henley opined that Joint Petitioners' obligation is to provide safe and reliable service at reasonable rates. He opined that even within the context of resource planning, which requires a least cost analysis, the Indiana Courts have found that the Commission's finding of "least cost" does not mean lowest cost, but rather, that the cost is reasonable, "consistent with providing reliable, efficient, and economical electrical service."[18]

(c) Commission Discussion and Findings. As in Cause No. 42685, IIG again seeks clarification that the inception of the ASM will not absolve the Joint Petitioners of their ultimate responsibility to operate their systems on a "least cost" basis. The Commission again notes, as it did in its June 1, 2005, that it has not used the FAC process to second guess utility decisions based

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[16] Ind. Code § 8-1-2-4.

[17] Ind. Code § 8-1-2-42(d)(1).

[18] *General Motors v. Indianapolis Power & Light Co.*, 654 N.E.2d 752 (Ind. Ct. App. 1995).

on hindsight.[19] The advent of ASM does not create any justification for a departure from the existing manner of review consistent with Ind. Code § 8-1-2-42, which requires a reasonable effort by a utility to provide power at the lowest cost reasonably possible.

(3) <u>Request for Mandatory Tariff Revisions to Allow Direct Participation in Midwest ISO Demand Response.</u>

(a) <u>IIG Evidence.</u> Mr. Dauphinais testified that Demand Response Resources must be available to the Midwest ISO to achieve the intended goals of the ASM. He provided several examples of how he believes the Midwest ISO had made clear in its filing at FERC that Demand Response Resources were a key component to the anticipated increase in competition in the ancillary services and energy market. He stated that absent a full utilization of Demand Response Resources, the Midwest ISO will not be able to fully obtain the flexibility, cost minimization, net annual benefits, or efficient acquisition and pricing of Operating Reserves expected by the Midwest ISO through the ASM.

Mr. Dauphinais testified that the Midwest ISO established ASM with the intent of utilizing Demand Response Resources and Generation Resources in a comparable manner. Failing to provide the Midwest ISO with access to Demand Response Resources will, Mr. Dauphinais explained, prevent the Midwest ISO from fully achieving its goals and operating the ASM as intended. According to Mr. Dauphinais, Indiana consumers as a whole will not receive the promised benefits of the ASM, if those Indiana consumers who are able to act as Demand Response Resources are not allowed to do so within the ASM.

Mr. Dauphinais opined that it is absolutely critical that the Commission take action now, as part of its decision in this case, to permit Indiana-jurisdictional end-use customers that can act as Demand Response Resources to fully and freely participate in the ASM. This is because the Midwest ISO has stated that retail load participation would need to comply with Federal and applicable state laws and regulations. He noted that an Indiana demand response resource will need to certify that it has obtained any required approvals from all applicable state regulatory agencies to enable such resource to participate in the Midwest ISO demand response programs.

Mr. Dauphinais testified that he believes absent full utilization of Demand Response Resources, the Midwest ISO's ability to achieve its goals of flexibility, cost minimization, net annual benefits, and efficient acquisition and pricing of regulation and contingency reserves will be undermined. He stated that permitting the Joint Petitioners to participate in the ASM while not taking the steps necessary to permit Indiana Demand Response Resources to participate in the ASM would fail to fully empower the Midwest ISO to attain the goals it hopes will be achieved through the ASM.

Mr. Dauphinais proposed that six months following the commencement of operation of the Midwest ISO ASM, each of the Joint Petitioners should be ordered to file with the Commission additional retail electric tariffs that provide the opportunity for their respective retail customers to participate in the Demand Response Resource, Emergency Demand Response Initiative, and Load Modifying Resource provisions of the Energy Markets Tariff. Mr. Dauphinais proposed that the

[19] *In re Verified Joint Petition of PSI Energy*, Cause No. 42685, pp. 13-14 (IURC 06/01/05).

tariffs should be developed jointly by the Joint Petitioners and interested parties to this proceeding. Mr. Dauphinais suggested that in the event the Joint Petitioners and the interested parties are not able to agree upon tariff language, the Joint Petitioners should file their proposed tariffs as part of a sub-docket in this proceeding and testimony in support thereof, and the interested parties may file their proposed tariffs and testimony in support thereof. The Commission would then schedule a hearing to resolve any differences.

Mr. Dauphinais also proposed that the retail tariffs provide that customers may participate either directly as Market Participants or through the Joint Petitioner, with the Joint Petitioner crediting all revenue due to the participant from the Midwest ISO except that the Joint Petitioner should retain an amount equal to the actual cost to the Joint Petitioner to administer the participant's participation. He explained that this is important because Indiana Demand Response Resources must be compensated as determined by the Midwest ISO, on an equal basis with non-Indiana Demand Response Resources, or at least two negative results will follow. First, Indiana participants will be disadvantaged as compared to others, in that they will not receive the same compensation as the others. Second, potential Indiana participants will not receive the payment determined by the Midwest ISO as necessary and appropriate to cause Demand Response Resources to participate, with the concomitant cost savings, efficiency gains, and increased competition that benefit all consumers.

Finally, Mr. Dauphinais proposed that the retail tariffs should expand on, and not replace, any existing demand response or interruptible programs, tariffs and/or contracts that the Joint Petitioners may individually already have on file with the Commission. He stated this was important because customers and Joint Petitioners have existing agreements that need to be honored.

(b) Joint Petitioners' Rebuttal Evidence. Joint Petitioners' Witness Henley testified that Joint Petitioners have significant concerns regarding IIG's request for direct participation in the Midwest ISO demand response tariff provisions and opined that IIG's recommendations go beyond the scope of this proceeding. Mr. Henley stated that approval of the IIG's recommendations would bring about a subtle (and perhaps unintended) erosion of state authority. Mr. Henley noted that the Commission supervises Indiana's utilities, both (1) as to retail rates and rate design, and (2) regarding resource planning. He concluded that IIG's proposal could have significant effects in both of these areas.

Mr. Henley stated that it appears that IIG is attempting to get blanket approval from the Commission for any and all customers to participate directly in the Midwest ISO demand response markets, when such approvals are better addressed on a case-by-case basis where a customer's specific request can be adequately analyzed. Mr. Henley pointed to the Midwest ISO TEMT provisions as apparently accommodating the two types of states located within the Midwest ISO footprint: states that have restructured their retail electric markets; and states, like Indiana, that have not engaged in retail electric restructuring but have maintained franchised utility systems. Mr. Henley testified that the Midwest ISO TEMT language takes this approach by allowing for participation by resources "hosted by an Energy Consumer *or Load Serving Entity*" (emphasis added). Indiana's franchised utilities are considered Load Serving Entities. Thus, the Joint Petitioners can participate in the Midwest ISO TEMT demand response provisions on behalf of individual retail customers. Similarly, he noted, the tariff revisions accompanying the Midwest ISO's December 31, 2007, Emergency Demand Response filing define Emergency Demand

Response Participant simply as "[a] Market Participant capable of reducing demand in response to directives received from the Transmission Provider during an Emergency event." Mr. Henley explained that in reality, the Joint Petitioners already act as aggregators of retail demand response. Additionally, he noted that the Joint Petitioners now have years of experience in dealing with Midwest ISO, the Midwest ISO markets, and the mechanics of interfacing with Midwest ISO systems on a day-to-day basis. Thus, the Joint Petitioners are experienced and well-positioned to respond to the demand response terms and conditions of the TEMT.

Mr. Henley asserted that existing state-authorized DSM programs have been crafted to provide an appropriate balance between the reduced tariff rates and overall benefits. Mr. Henley further explained that IIG's recommendation may make sense in a state that has provided for a deregulated retail electric market. However, in Indiana, a state where the legislature has made a policy decision to continue to operate on a franchised service territory basis under the oversight of the Commission, IIG's proposal would have certain inequitable consequences. Mr. Henley opined that IIG's proposal would allow certain larger industrial or commercial customers that can afford the sophisticated metering and communications equipment to participate, but the participation would be subsidized by other customers who would have to make up the increase in resources necessary because the Joint Petitioners would no longer have control over the timing or the use of the DSM resources to moderate their peak load and manage their overall resource adequacy requirements on a reasonable cost basis.

Mr. Henley noted that the Organization of MISO States ("OMS") recognized in its November, 2007 "Statement of Principles for Demand Resources," that the Midwest ISO should support state commission responsibility in the setting of rules and conditions of service for retail demand response programs; and should encourage flexibility to load serving entities to offer retail demand response resources into the markets in a way that preserves both state and regional interests. Mr. Henley stated that all of the Joint Petitioners have legacy load control and interruptible tariffs, approved by the Commission in various proceedings, after consideration of the characteristics of the regulated utility and its customers. He further indicated that the Joint Petitioners concur with the OMS that these tariffs should continue and may be more valuable if they are consistent with a well-functioning wholesale electric market; and that legacy programs should not be required to participate in the Midwest ISO market.[20] Mr. Henley concluded that existing state programs are well-established, while the Midwest ISO's demand response tariff provisions will be implemented through ASM software and procedures that are still being developed.

Mr. Henley also opined that in the event IIG's proposal were adopted, participation in the existing DSM programs may decline due to the potential confusion or overlapping nature of existing utility supported demand response initiatives and the Midwest ISO TEMT provisions. He stated that customers who develop the ability to participate in a Midwest ISO demand response market will likely leave existing programs for riskier but purportedly higher compensation from the proposed market. Such loss of participation in existing programs may have a negative effect on a utility's remaining customers through increased costs due to the need to purchase additional reserves.

Mr. Henley stated that Joint Petitioners have been supportive of the Midwest ISO and its attempt to increase the demand response capability of the market through active participation in the

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[20] OMS Midwest Demand Response Initiative Statement of Principles for Demand Resources, November 8, 2007, p. 2.

Midwest ISO Demand Response Working Group and the Midwest Demand Response Initiative, and all related stakeholder efforts for Emergency Demand Response and the ASM. He testified that Joint Petitioners believe any participation in the Midwest ISO demand response provisions must be structured so as not to have unintended adverse impacts on a subset of customers, or on the ability of the utility to accurately, reliably and cost effectively plan its system. He explained that under the franchised service territory model in place in Indiana, the utility has the responsibility to manage its overall resource portfolio for the benefit of its retail customers. Mr. Henley stated that while demand response provisions can and should be developed to capture potential benefits of bidding certain resources into the Midwest ISO ASM, any participation should be coordinated by each Joint Petitioner for its service territory, to ensure that the tariff provisions are coordinated in compliance with the state resource adequacy requirements, including maintaining adequate planning reserves. Mr. Henley asserted that revenues for participation should then be allocated in a manner reflecting the respective burden and benefits to each customer class.

Mr. Henley explained that tariff changes could be made to better facilitate or clarify the financial benefits to load of the Midwest ISO markets, and noted that Joint Petitioners have worked with their larger, more energy-sophisticated customers to develop their current demand response tariff offerings. Mr. Henley expressed the Joint Petitioners' expectations that they would work with their larger customers to add additional or modify existing state tariffs to operate effectively with the Midwest ISO TEMT. Mr. Henley concluded that Joint Petitioners concur with the OMS recommendation that the distribution of revenues to demand resources should reflect the values contributed by all of the utility's customers and the utility.

(c) Commission Discussion and Findings. When various industrial customers filed a Complaint seeking a FERC order directing PJM Interconnection, L.L.C. ("PJM"), and American Electric Power Service Corporation ("AEP") to allow members of the PJM Industrial Customer Coalition ("PJMICC") to participate in PJM's Emergency Load Response Program and Economic Load Response Program, the Commission filed an intervention and protest noting that in Indiana, the legislature has not found that it is in the public interest to alter its traditional regulation of the relationship between retail power use and utilities. In Indiana, which follows a more traditional cost-of-service model, we exercise broad oversight over retail sales and service. We noted that the Commission also regulates the establishment, administration, and cost recovery of demand response programs for its jurisdictional utilities – including AEP's Indiana-Michigan affiliate. We noted that the Complaint raised fundamental questions regarding the relationship and order of federal and state involvement in a transaction where a beneficiary of a traditionally state-regulated activity –the retail use of electric power– seeks to make direct use of a federally-approved tariff. We stated that we have a duty to consider the effects of any proposed partial departure from a local provider's system on the integrity and future operation of that system.[21] Ultimately, a customer's decision to use electricity or conserve electricity is a retail decision that is subject to tariffs approved by this Commission, considering the costs and benefits to all customers of the affected utility.[22]

[21] Notice of Intervention and Protest of the Indiana Utility Regulatory Commission, filed May 18, 2005, in PJM Industrial Customer Coalition, Complainant v. PJM Interconnection, L.L.C. and American Electric Power Service Corp., Respondents, Docket No. EL05-93-000.

[22] The Commission notes that subsequent to its Intervention and Protest, PJM filed a Supplement to the Answer of PJM stating that it would honor the Commission's protest and request that individual end-use customers obtain Commission approval prior to participation in the PJM load response programs. The Commission has approved unopposed Petitions

We agree with Joint Petitioners' position that the relationship of demand response with integrated resource planning and other aspects of state ratemaking is complex and that a new layer of Midwest ISO demand response tariffs cannot simply be added without also considering existing retail tariff structures. We also agree with Joint Petitioners that existing demand response programs were crafted to balance costs and benefits appropriately among different ratepayers. And, any development of new tariffs will appropriately require a review of existing retail tariff structures with any eye toward demand response incentives which already exist, as well as those which are promised through the Midwest ISO markets.

As noted by Witness Henley, existing retail demand response tariffs and riders have received the benefit of full review by this Commission. However, IIG's proposal would at least partially bypass this Commission's review of demand response measures – measures that will undoubtedly affect other retail customers (*i.e.*, residential consumers). As Witness Henley has testified, the Midwest ISO TEMT is drafted in a manner that recognizes states that have chosen to maintain traditional franchised retail service and rates. Declining IIG's request will, in no way, hinder Joint Petitioners' participation in ASM, and in fact, will maintain this Commission's statutory oversight of the rates, terms and conditions of retail service. We also note FERC's recent finding that "the provisions in the Midwest ISO's tariff are not intended to prevent participation in any state-approved load control programs or restrict rate recovery from retail customers."[23]

Consequently, as Mr. Henley noted, issues related to the various retail tariff offerings or special contracts of individual Joint Petitioners and issues related to how such Joint Petitioners will use their demand response resources, given the various Midwest ISO demand response options and requirements, are better suited for discussion in other proceedings – such as individual energy efficiency filings, special contract filings, or demand response tariff filings. Therefore, we decline IIG's invitation to require Joint Petitioners to revise their respective tariffs at this time to allow direct participation in the tariff provisions of the Midwest ISO.

However, the Commission believes that as demand response resources and measures are becoming increasingly prevalent, it should further evaluate possible procedures for considering and, if appropriate, streamlining requests by end-use customers seeking to participate in the various demand response programs offered by RTOs in Indiana. Therefore, we find that the Commission should commence an investigation within thirty (30) days of this Order to examine any and all issues associated with an end-use customer's participation in demand response programs offered by the Midwest ISO and the PJM Interconnection.

6. <u>Deferral of Specific Costs During Pendency of this Proceeding.</u>

(1) <u>Joint Petitioners' Evidence.</u> The Joint Petitioners submitted testimony from James L. Cutshaw to support their request to defer any reasonably incurred costs from the start of the ASM

(on a trial basis, pursuant to settlement agreements with the OUCC) from two industrial customers within Indiana to participate directly in the PJM Market as demand response resources. *See In Re Petition of Steel Dynamics, Inc. for Approval to Participate in PJM Load-Response Programs*, Cause No. 43138 (IURC 7/25/2007) and *In Re Petition of Indiana Mich. Power Co. and IN TEK for Approval of the Fifth Amendment to the Contract for Electric Service*, Cause No. 43300 (IURC 8/8/2007). The terms of the agreement between the applicable utilities and the customers in these cases are confidential and were not disclosed.

[23] *Midwest Independent Transmission System Operator, Inc.*, 123 FERC P61,297, at ¶ 86, *citing, Midwest Independent Transmission System Operator, Inc.*, 123 FERC P61,070, at ¶ 26 (2008).

beginning with the financially-binding testing of the market and continuing until a final determination is made by the Commission on the issue of cost recovery. Mr. Cutshaw stated that Joint Petitioners plan to address (in either their FACs or Midwest ISO tracker proceedings) certain existing Midwest ISO charges that are being modified as a result of ASM and certain new Midwest ISO charges that are replacing charges that have been previously approved by the Commission for cost recovery. He testified that the Joint Petitioners are proposing that certain clearly identified costs associated with the start of the ASM as a result of taking transmission service under the Midwest ISO TEMT (as identified by certain new Midwest ISO charge types[24]) be deferred in FERC Account 182.3, Other Regulatory Assets, for subsequent recovery following a final determination by the Commission on the issue of cost recovery in Phase 2 of this proceeding.

Mr. Cutshaw sponsored Joint Petitioners' Exhibit 3-A, which compared current Midwest ISO charge types with charge types proposed to be in place after ASM. Joint Petitioners' Exhibit 3-A included a listing of current Midwest ISO "Day-2" charge types and identified where individual charge types were modified by rules for the ASM. In those cases where a charge type was modified, a brief explanation described the change. Joint Petitioners' Exhibit 3-A also included a listing of new charge types that were created by the ASM. Mr. Cutshaw explained that the Joint Petitioners are requesting authority to defer the net amount of charges and credits for those items identified as "New" charge types in Joint Petitioners' Exhibit 3-A (with the exception of the new Non-Excessive Energy Amount and the new Excessive Energy Amount charge types) until a final determination by the Commission on the issue of cost recovery. He stated that these charge types (other than the new Non-Excessive Energy Amount and the new Excessive Energy Amount charge types) represent the costs load will pay for regulation, spinning reserves and supplemental reserves – ancillary services provided through the Midwest ISO; the revenues generators will receive for reserving generation for purposes of regulation, spinning reserves and supplemental reserves; and certain costs and credits associated with differences between reserved amounts and actual services provided when called upon.

Mr. Cutshaw further explained that Joint Petitioners, in their respective FACs or other appropriate proceedings, will be requesting authority to treat for ratemaking purposes the new Non-Excessive Energy Amount and the new Excessive Energy Amount charge types in the same manner as the existing Real Time Asset Energy Amount, subject to refund pending a final determination by the Commission in this proceeding on the issue of cost recovery. He also testified that the existing Real Time Uninstructed Deviation Amount, and the Real Time Uninstructed Deviation Credit should be treated in the same manner as they are today by each of the Joint Petitioners, subject to refund pending a final determination by the Commission in this proceeding on the issue of cost recovery. Mr. Cutshaw noted that if the two new replacement charge types to be implemented under ASM were included in the net deferral amount rather than continued in FAC recovery, retail customers would see increased fuel costs during the interim period before the final cost recovery determination by the Commission in this proceeding. This is because the real time generation credit would no longer be included in the computation of the FAC rate.

Mr. Cutshaw testified that Joint Petitioners will propose in their respective FAC or other appropriate proceedings that those items identified as "Modified", along with all other existing

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[24] The charge types may represent either charges or credits to Joint Petitioners. When Mr. Cutshaw referred to deferral of costs in his testimony, Mr. Cutshaw indicated that he meant the net of the charges and credits from these specific Midwest ISO charge types.

charge types which are not affected by the implementation of ASM, would continue to be treated for ratemaking purposes as they are today by each of the Joint Petitioners until a final determination by the Commission in this proceeding on the issue of cost recovery. He concluded that in aggregate, the requested and proposed accounting and ratemaking treatment is a fair and reasonable method to help prevent rate volatility for customers during the interim period, before final determination of ASM cost recovery by the Commission; and will also protect the Joint Petitioners' shareholders from similar earnings volatility during the interim period.

(2) OUCC Evidence. OUCC Witness Satchwell testified that the Commission should approve deferral of reasonably incurred ASM-related costs until final determination by the Commission on cost recovery in Phase II of this proceeding.

(3) IIG Evidence. IIG Witness Dauphinais testified that the recovery or crediting of all Midwest ISO settlement charge, credit and revenue types, be they deferred or not, should be subject to the outcome of Phase II of this proceeding.

(4) Joint Petitioners' Rebuttal Evidence. Joint Petitioner Witness Henley noted that the Joint Petitioners and the OUCC filed a joint motion at the Prehearing Conference, which was unopposed by all parties, which provided that the Joint Petitioners should be allowed to defer any reasonably incurred ASM-related costs pending a final determination of the Commission on the issue of cost recovery. Mr. Henley stated that he did not know whether Mr. Dauphinais was attempting a collateral attack on this agreement, but that given the timing of the Phase II hearing in this proceeding, it would be impossible to have an order regarding recovery of ASM costs prior to the start of the market. Therefore, he argued, it is reasonable to allow Joint Petitioners to defer specifically identified ASM costs pending the Commission's final determination on the issue of cost recovery. Mr. Henley expressed concern with the omission of the descriptor "ASM-related" from Mr. Dauphinais' recommendation. Mr. Henley asserted that Midwest ISO settlement charge, credit and revenue types that are not impacted by the ASM should not be subject to the outcome of Phase II of this proceeding. Mr. Henley also noted that there are certain charge types where it is impossible to discern which portion is attributable to ASM. For example, he stated it would be impossible to discern the impact of ASM on the Day Ahead Market Administration charge, and collection of these charges should not be negatively impacted by the decision in Phase II of this proceeding.

(5) Commission Discussion and Findings. The Joint Petitioners are requesting authority to defer the net amount of charges and credits for those items identified as "New" charge types in Joint Petitioners' Exhibit 3-A, with the exception of the new Non-Excessive Energy Amount and the new Excessive Energy Amount charge types, until a final determination by the Commission on the issue of cost recovery. They also request that the Commission's Order in Phase I of this proceeding provide a reasonable degree of assurance of the future recovery of new ASM costs by each Joint Petitioner that is required by the applicable accounting rules to permit each Joint Petitioner to defer such costs on its books of accounts. Under the Joint Petitioners' proposal, any change in their respective rates would follow a final determination by the Commission on the issue of cost recovery. With respect to the new Non-Excessive Energy Amount and the new Excessive Energy Amount charge types, Joint Petitioners proposed that they would address these charge types in their respective FAC or RTO proceedings, subject however to a final determination by the Commission on the issue of cost recovery in this proceeding.

Joint Petitioners also proposed that in each of their respective FAC or other appropriate proceedings, those items identified as "Modified", along with all other existing charge types which are not affected by the implementation of ASM, would continue to be treated for ratemaking purposes as they are today by each of the Joint Petitioners until a final determination by the Commission in this proceeding on the issue of cost recovery. The Commission finds this proposal reasonable.

Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation ("SFAS 71"), provides rules that address when certain regulated entities are permitted to defer costs that would otherwise be charged to expense in the period incurred.

In Cause Nos. 42257 and 42266, which involved Joint Petitioners Duke Energy Indiana, IPL, and Vectren, the Commission approved the deferral of certain Midwest ISO administrative costs, noting:

> As a result of FERC Opinion Nos. 453 and 453-A, Joint Petitioners must take transmission service under the Midwest ISO OATT to serve their respective Indiana retail electric customers. Joint Petitioners are "transmission customers" under the Midwest ISO OATT with respect to the transmission service taken by them to serve their Indiana retail electric customers. The "transmission customer" status of a Joint Petitioner applies even to the transmission of electricity produced at generating facilities owned and operated by a Joint Petitioner and transmitted across transmission facilities owned by a Joint Petitioner, and even though such transmission service is provided as part of the Joint Petitioner's bundled retail electric service to its respective Indiana retail electric customers.
>
> A Joint Petitioner taking transmission service under the Midwest ISO OATT is comparable to an Indiana retail gas utility taking gas transportation service from an interstate gas pipeline to serve its Indiana retail gas customers. In both situations, an Indiana utility incurs costs to serve its Indiana retail customers based upon FERC approved rates set forth in FERC approved tariffs. Just as an Indiana gas utility is permitted by the Commission to recover from its Indiana retail gas customers the utility's gas transportation costs incurred under a FERC approved tariff to serve those customers, each Joint Petitioner should be permitted to recover from its respective Indiana retail electric customers its transmission costs incurred under the Midwest ISO OATT to serve those customers.

In re Joint Petition of PSI Energy, Inc. and Vectren Energy Delivery of Ind., Inc., Cause Nos. 42257 and 42266 at p. 4. (IURC 12/11/2002).

The situation of Joint Petitioners is the same in this Cause. We have approved their participation in the Midwest ISO's co-optimized energy and ancillary services market, and therefore find that Joint Petitioners should be allowed to defer the attendant costs as identified in Appendix A, attached hereto and made a part hereof, until a final determination by the Commission on the issue of cost recovery in Phase II of this proceeding. With respect to the new Non-Excessive Energy Amount and the new Excessive Energy Amount charge types, we approve Joint Petitioners' proposal that they address these charge types in their FAC or RTO proceedings, subject however to a final determination by the Commission on the issue of cost recovery in this proceeding. In addition, Joint Petitioners' proposal to continue to treat those items identified as "Modified" on Appendix A for ratemaking purposes in each of their respective FAC or other appropriate proceedings, just as they are today, until a final determination by the Commission in this proceeding on the issue of cost recovery, is reasonable and is hereby approved.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. Joint Petitioners are authorized to transfer additional balancing authority functions in accordance with the Amended Balancing Authority Agreement and implement the operational changes necessary to permit Joint Petitioners to participate in the Midwest ISO's ASM.

2. A subdocket, Cause No. 43426 S1, is hereby created to allow for further consideration of whether, and to what extent if any, a cost-benefit analysis of the Joint Petitioners participation in the Midwest ISO or the Midwest ISO ASM should be performed and whether any additional data concerning ASM costs and benefits should be provided in the Joint Petitioners' respective FAC filings. A prehearing conference and preliminary hearing is hereby scheduled for September 2, 2008 at 10:00 a.m. in Room 224 of the National City Center, 101 West Washington Street, Indianapolis, Indiana.

3. Within thirty (30) days of the date of this Order, the Commission will commence an investigation into any and all matters related to approval by the Commission of participation by Indiana end-use customers in demand response programs offered by either the Midwest ISO or the PJM Interconnection.

4. Joint Petitioners are authorized to seek recovery in their respective FAC or other appropriate proceedings, those items identified as "Modified" in Appendix A attached hereto, along with the new Non-Excessive Energy Amount and Excessive Energy Amount Charge types. The modified charges may continue to be treated for ratemaking purposes as they are today by each of the Joint Petitioners until a final determination by the Commission in this proceeding on the issue of cost recovery.

5. Joint Petitioners are authorized to defer certain identified ASM costs consistent with Appendix A attached hereto.

6. This Order shall be effective on and after the date of its approval.

HARDY, LANDIS, AND ZIEGNER CONCUR; GOLC AND SERVER ABSENT:

APPROVED: AUG 13 2008

I hereby certify that the above is a true and correct copy of the Order as approved.

Brenda A. Howe

Brenda A. Howe
Secretary to the Commission